EUROPEAN EQUITIES

EUROPEAN SMID CAPS: SMALL IS BEAUTIFUL

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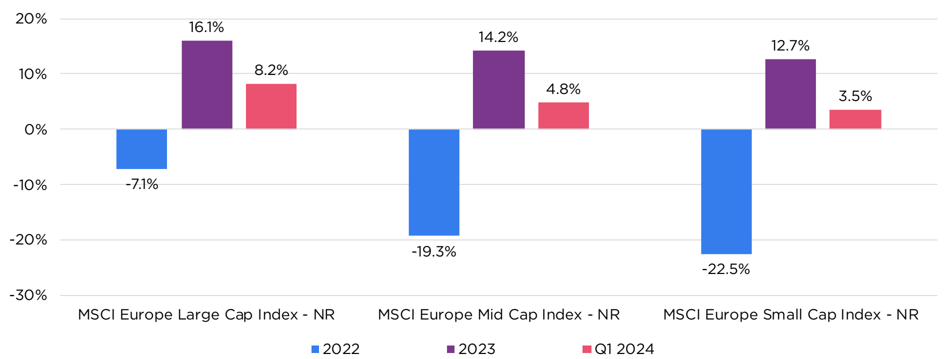
SMID caps have underperformed in recent years. Despite this trend, we believe that there are several examples of smaller companies in Europe that possess the right mix of quality characteristics and growth drivers to potentially deliver substantial returns over the long run.

SIZE DOESN'T MEASURE QUALITY

In recent years, smaller companies have fallen out of favour with investors as large-cap companies have recorded outsized returns (as shown in *figure* 1). The outperformance of large-cap companies in the United States (especially the so-called "Magnificent Seven" stocks[1]) and Europe (as highlighted in our earlier paper, "Giant Steps for Europe") has dominated news headlines and diverted investor attention away from the small- and medium-sized companies of Europe.[2] Higher global interest rates over the past three years also reduced investor interest in smaller companies. These companies generally carry a higher share of debt and promise higher growth, making them disproportionately affected by higher interest rates.

Figure 1. Absolute performance by market capitalisation



*Source: Comgest/Factset. Data in EUR at 31-Mar-2024. *Large Cap data for MSCI Europe Large Cap Value vs MSCI Europe Large Cap Growth; Mid Cap data for MSCI Europe Mid Cap Value vs MSCI Europe Mid Cap Growth; Small Cap data for MSCI Europe Small Cap Value vs MSCI Europe Small Cap Growth.*

We believe that this overly simple analysis – based on large-cap performance, interest rates and other macroeconomic developments – neglects the promising long-term growth potential of certain smaller companies in Europe.

[1] Includes Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla.
[2] This paper can be found under the "Our Thinking/Investment Letters section of your local Comgest website.

There is a wide range of performance outcomes in the small- and medium-capitalisation (SMID cap) company universe[3], which is why we believe that active management and selective stock-picking are critical. Small- and medium-sized companies are the backbone of the European economy, accounting for nearly two-thirds of all jobs and more than half of the continent's value added.[4] Being able to narrow this immense universe of stocks and separate the winners from the losers requires extensive research.

Smaller companies tend to carry more debt in their balance sheets have stronger operating leverage and more limited regional footprints than large-cap alternatives. Despite these challenges, we believe that there are several examples of SMID cap companies with the enduring competitive advantages of established market leaders. Many of these companies operate in niche markets, such as payment platforms, restaurant vouchers or professional kitchen equipment, yet they are industry leaders. While investing in SMID caps involves risk, we believe that those managers who can spot quality SMID caps can potentially achieve substantial long-term returns.

At Comgest, our investment philosophy is not constrained by size. We aim to build our portfolios with quality companies with enduring competitive advantages, irrespective of their size or market capitalisation. Our disciplined and rigorous investment approach aims to identify distinct drivers of growth and focus on companies that we believe are poised for sustained earnings growth. For our Comgest Growth Europe Smaller Companies strategy we target mid-teens earnings per-share growth over our five-year forecasting period versus low-teens for our large cap flagship Comgest Growth Europe strategy.

The value for long-term investors in our Comgest Growth Europe Smaller Companies strategy lies in benefiting from the small cap effect, which should offer higher long-term earnings growth and greater appreciation potential compared to large cap companies. The recent underperformance of our Comgest Growth Europe Smaller Companies strategy compared to our large- and mega-cap strategies may present an excellent opportunity to invest in the dynamic earnings growth of high-quality smaller European companies.

While there are common threads across industries, we believe that there is no "one size fits all" approach when it comes to identifying the competitive advantages that set certain European SMID caps apart. We have observed that the competitive advantages of European SMID caps can take many forms, including serving as a linchpin for global supply chains, leveraging in-house innovation and maintaining a strong brand presence.

CONNECTING GLOBAL SUPPLY CHAINS

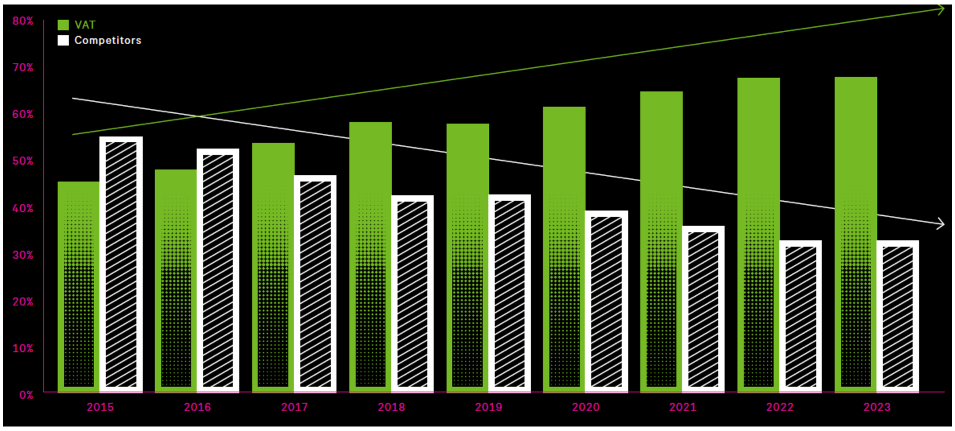
In some cases, large caps are highly dependent upon smaller companies. The intricate global supply chains of many of the world's leading companies are composed of SMID caps. In the semiconductor industry, for instance, companies require highly specialised tools and pieces of equipment to produce their end products – many of which are only manufactured by a handful of smaller companies.

[3] Refers to companies with a market capitalisation between $250 million and $10 billion.
[4] European Commission. "Annual Report on European SMEs 2022/2023." European Commission. Accessed 8-Aug-2024.

PASSION. PRECISION. PURITY.

VAT Group, the Swiss industrial equipment manufacturer, is one of the leading suppliers of high-end vacuum valves used by leaders in the semiconductor industry. Vacuum systems are used at various points of the semiconductor manufacturing process to reduce contamination and regulate temperatures. Dust, for instance, can disrupt the manufacturing process and cause costly defects to the chip manufacturing process.

Figure 2. Market share of VAT's Semiconductor Branch (Market share Semi and related)



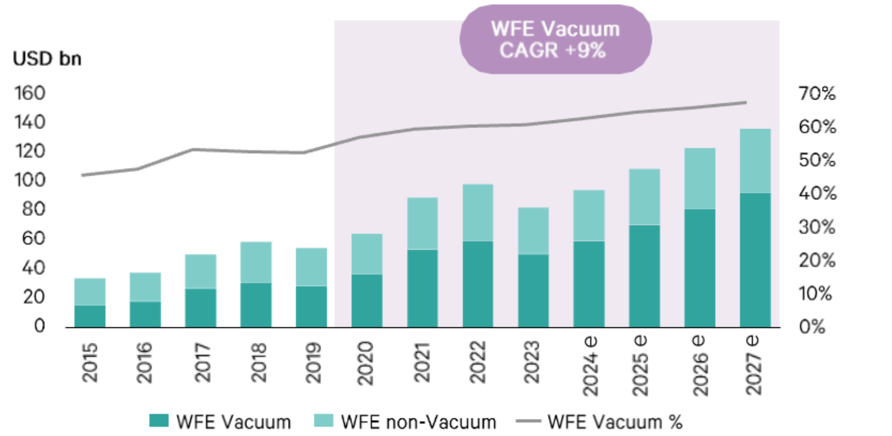
*Sources: Sources: VAT / Company website. "VAT Annual Report 2023." *Market share includes semiconductors, LEDs and hard disks. Data on positions held are provided for information purposes only, are subject to change and constitute neither a recommendation to buy nor a recommendation to sell the securities displayed. The securities presented in this document may not be held in portfolio at the time of receipt of this presentation. All projections and estimates are provided for information purposes only and are not guaranteed.*

Founded in 1965, VAT Group has steadily grown its share of the semiconductor valves market from 54% in 2015 to around 70% in 2023 (as seen in *figure* 2).[5] In 2022, VAT Group had the highest installed base in the market with 1.5 million valves installed.[6] As a leading provider of semiconductor valves, the company's quality is trusted by many of the world's leading semiconductor manufacturers, such as ASML, TSMC, Intel and Samsung. VAT Group also boasts the broadest portfolio of products on the market, including 8,000 customer-specific products and 2,500 standard products.[7] We believe VAT Group's market share, as well as their close relationships with the world's leading semiconductor manufacturers, should serve as high barriers to market entry for potential competitors.

In our view, VAT Group also benefits from a variety of long-term growth drivers, including digitisation and artificial intelligence. Based on these trends, the company expects the semiconductor equipment market (also known as wafer fab equipment "WEF") to grow at a 9% compound annual growth rate until 2027 (see *figure* 3). We believe that VAT Group is well-positioned to take advantage of this growing demand, especially as the semiconductor manufacturing process becomes more complex and manufacturers race to produce smaller chips. With little debt, an experienced management team, as well as high returns on capital and margins[8], we believe that VAT Group has many of the durable competitive advantages that separate quality growth companies from the rest of the pack.

[5] Sources: VAT / Company website. "VAT Annual Report 2023."
[6] Source: VAT / Company website. "VAT Summary Report 2022."
[7] Source: VAT / Company website. "VAT Investor Deck Winter 2023."
[8] Source: VAT / Company website. "VAT Half-Year Report 2024."

Figure 3. Strong medium-term investment growth in semiconductor production equipment (WFE)



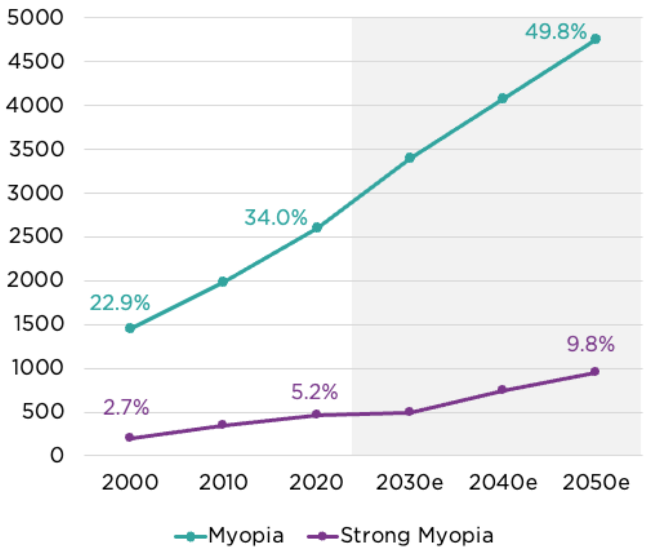
*Sources: VAT / Compagny website/ VLSITechInsights Inc / Investor Deck Winter 2023. *WFE = Wafer Fab Equipment. Data on positions held are provided for information purposes only, are subject to change and do not constitute a recommendation to buy or sell the securities displayed. The securities presented in this document may not be held in portfolio at the time of receipt of this presentation. All projections and estimates are provided for information purposes only and are not guaranteed.*

LEVERAGING INNOVATIVE SOLUTIONS

Although smaller companies typically have smaller research and development budgets than their larger peers, their dedication to niche markets can sometimes make them technological leaders – even against bigger competitors. In other words, they are big fish in a pond too small for their larger peers.

German manufacturer **Carl Zeiss Meditec**, for instance, has established leading positions in the eye-related medical technology industry due largely to its highly innovative laser technology. As of August 2024, the company was the market leader for microsurgery visualisation (> 60%), refractive surgery (> 35%) and fragmented eye diagnostics (~20%).[9]

Figure 4. Worldwide prevalence of myopia (in millions of persons)



Sources: Carl Zeiss Meditec / Company website / Estimates American Academy of Ophthalmology / BGN Eye Clinic Lasik Surgery In Korea.

Notably, the company has released an innovative laser vision correction software called "SMILE," which is less invasive than other forms of refractive surgery, including LASIK. In particular, the incision size of SMILE is about two millimetres compared to 24 millimetres for LASIK. The worldwide presence of myopia, also known as "shortsightedness", has grown from 22.9% in 2000 to 34.0% in 2020 and is expected to grow to 49.8% by 2050 (as shown in *figure* 4).

Given this unfortunate rise in myopia and a growing global ageing population, we believe that demand for refractive surgery will only rise in the future. In our view, Carl Zeiss Meditec's laser technology should be well-positioned to provide patients with solutions and treatments for their eye-related conditions. Based on our experience, we believe that Carl Zeiss Meditec's innovation lead in these eye-related medical technology sectors have the potential to transform into a sustainable competitive advantage with long-term benefits for shareholders over time.

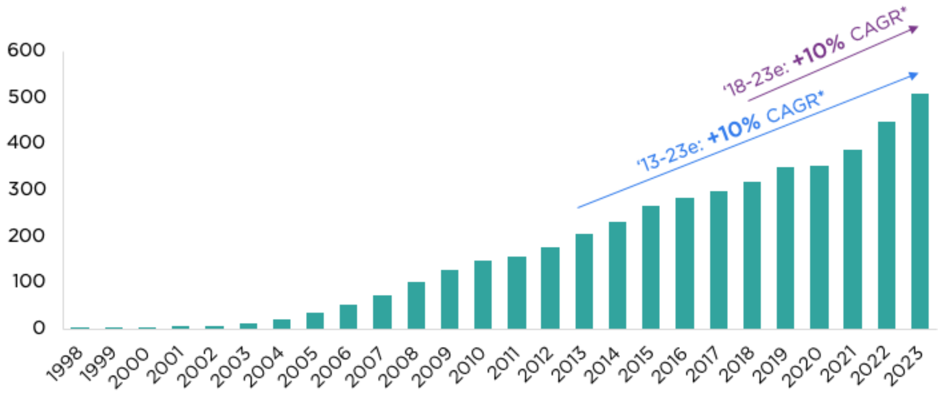
[9] Source: Carl Zeiss Meditec Group Investor Presentation August 2024.

SERVICING CLIENTS

In our view, size has nothing to do with a company's consumer reputation. With over 25 years of operation, **Scout24**, the leading German online listings platform, has built a strong brand presence in Germany. The company's real estate listing site, ImmobilienScout24.de, serves as a digital marketplace for real estate agents, tenants, homeowners and homebuyers.

Immoscout's website attracts more than 19 million users a month and had an annual traffic increase from 1.5x to 2.0x between 2018 and 2023.[10] In recent years, Scout24 has rolled out new products and innovative features to assist homeowners in accessing their property values and ensure compliance with local sustainability requirements.

Figure 5. Sales performance – Immoscout (Eur m)



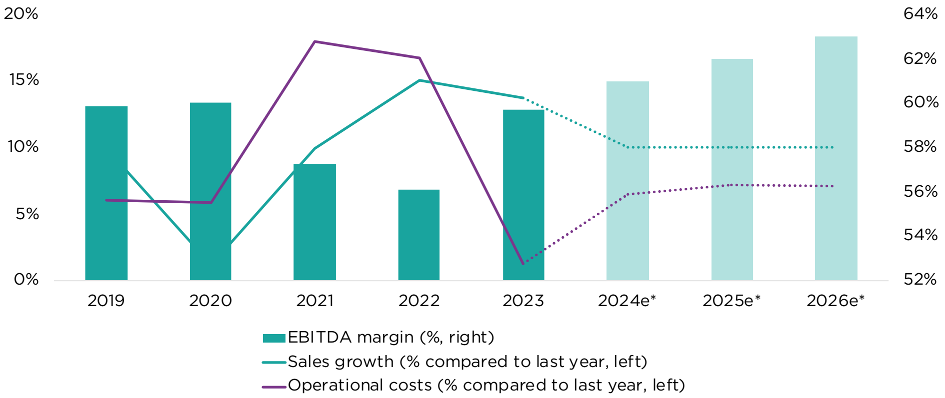
*Sources: Scout24. *CAGR: compound annual growth rate. Data on positions held are provided for information purposes only, are subject to change and constitute neither a recommendation to buy nor a recommendation to sell the securities displayed. The securities presented in this document may not be held in portfolio at the time of receipt of this presentation.*

For homebuyers and tenants, the company has premium feature options, including exclusive listings and a cloud-based application folder for managing the required documents for transactions.

Faced with a challenging real-estate market, especially in Germany where higher interest rates and rising building costs have pushed up housing prices, Scout24 has achieved a 10% compound annual growth rate since 2013.[11] In the wake of the COVID-19 pandemic, Scout 24 reinvested capital back into the company in 2021 and 2022, which helped increase sales growth.[12] Following this period of expenditure, Scout24 focused on reducing its operational costs in 2023 and delivering improved profit margins[13] Given the company's long-standing presence and innovative solutions, we believe that Scout24 has the potential to continue to increase its earnings growth over the long term.

[10] Source: Google Trends, Similarweb.
[11] Source: Scout24/Company website. Capital Markets Day Presentation 2024.
[12] Source: Scout24/Company website. Preliminary results for Q4/FY 2023.
[13] Source: Scout24/Company website. Preliminary results for Q4/FY 2023.

Figure 6. Scout24 reducing operational costs to deliver improved profit margins



*Sources: Scout24. *Estimates published by Scout24 Data on positions held are provided for information purposes only, are subject to change and constitute neither a recommendation to buy nor a recommendation to sell the securities displayed. The securities presented in this document may not be held in portfolio at the time of receipt of this presentation. All projections and estimates are provided for information purposes only and are not guaranteed.*

EXPLORING UNEXPLORED OPPORTUNITIES

We choose to invest in SMID caps because of their quality growth characteristics – not their size. Due to the recent underperformance of European SMID caps compared to their large-cap counterparts, we believe that there are several smaller companies with significant competitive advantages. In our view, the return of inflation – which peaked in June 2022 – led investors to overlook European SMID caps as they are generally considered to be more indebted and very susceptible to higher interest rates than larger companies.

As Eurozone inflation recedes,[14] we believe that now is a prime opportunity to invest in small cap companies with strong fundamentals, such as **VAT Group, Carl Zeiss Meditec** and **Scout24**. These companies are niche market leaders and have proven that they can outlast challenging economic times, including the COVID-19 pandemic and higher interest rates, due to their strong competitive advantages. Consistently overlooked by investors over the recent past, we see the opportunity to uncover quality growth small cap companies with potential long-term growth trajectories.

[14] European Commission. Spring 2024 Economic Forecast: A gradual expansion amid high geopolitical risks, 15-May-2024.

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- The value of all investments and the income derived therefrom can decrease as well as increase.
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Denis Callioni joined Comgest in 2015 and is an Analyst and Portfolio Manager specialising in European equities. She co-leads the Europe Smaller Companies and Europe Opportunities strategies, contributes to idea generation and researches European companies within a broad range of sectors. Denis started her career in 2010 as an equity Analyst at Kempen & Co Merchant bank in Amsterdam. She holds a Master's degree in Corporate Finance and Banking from Duisenberg School of Finance (the Netherlands) as well as a Master's degree in Business and Economics obtained from the University of Amsterdam. Denis is a CFA® charterholder.

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Eva Fornadi joined Comgest in 2005 and is an Analyst and Portfolio Manager specialising in European equities. She is also a non-executive member of the Board of Partners. She co-leads the Comgest Renaissance Europe, Comgest Growth Pan Europe Large Cap, Comgest Growth Europe Compounders, Comgest Growth Europe Smaller Companies and Comgest Growth Europe Opportunities funds. Eva holds a Bachelor's degree with Honours in Business Studies from Oxford Brookes University in the UK and a Bachelor's degree in Business Studies from the International Business School in Budapest, Hungary.

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